Corporate Structure and Financing

The majority of franchisees are required to adopt one of the following business formats: S-Corp, C-Corp, or LLC. If you have specific considerations for the corporate structure of your franchisees, outline them below.

Setting up Your Entity

Before you begin operating your Caring for People Services franchise, you will need to form an entity to serve as the operator. An entity is a legal fiction that allows a business to take on a separate existence, apart from its owners, even though the owners still control the business.

Whatever the business type, you must make sure the name you select isn't currently used by another business. There are several organizations that can help you search. The State Department of Revenue or the Secretary of State Offices are good places to start. Some states will also have a business license database that is searchable. The database can help you determine if the name you selected for your business is already taken. Registered names at the federal level can be searched via the US Patent and Trademark Commission.

Legal Business Structures

After successfully naming your business entity you need to determine how to organize the business legally so you can register it and apply for the required licenses. What are legal structures and what type(s) should you consider? C-corporations, S-corporations, limited liability companies, sole proprietorships, and partnerships are some of the more common options for business legal structures. There are differences and similarities in each that can dramatically affect the future of your company. Failing to structure your business in the most appropriate way (given your goals) can lead to negative outcomes, including higher than expected tax payments, excessive administrative work and costs, and unexpected loss of your personal assets.

There are three key issues that differentiate the various types of business structures. By understanding these core issues first, you will be able to understand the advantages and disadvantages of each type of structure.

1) Taxes: How many times will I pay tax?

   a) It's not a matter of if you will pay tax, but rather how many times you will pay tax. Certain structures are called pass-through entities, and income and losses are literally passed through from the business to the individual for tax purposes. Other structures form a separate tax entity that is taxed by itself. Then, when earnings are distributed, the owner is taxed again on that income.

What about liability?

   b) If you drive your car into another car, then you are liable for damages. Who is liable for the possible damages and debts incurred by your business? It depends on the type of structure. Some structures will limit your liability to your investment; others will make you and your personal possessions liable for the damages and debts of the business.

   c) You could lose everything you own in your business and in your personal possessions. This means your car, your house, your personal bank account and more. Your business can incur damages in any number of ways. For example, if you end up going bankrupt and still have outstanding bills, the creditors will come after your personal assets. Also, if a driver for your company accidentally kills a pedestrian, your business can become liable. Depending on the business structure, your personal possessions may also be at risk.

2) What about the time and cost to set up?

   a) How much time, effort, and money will it cost you to set up and run the company? Some structures are very costly in this sense while others are relatively low maintenance. While the first two issues (taxes and liability) are more important overall, administrative costs should not be overlooked. The costs of both money and time can be cumbersome, especially for a startup with fewer resources. These expenses include tax filing requirements, complexity of startup documentation with appropriate agencies (i.e. articles of incorporation), and both federal and state laws dictating necessary behaviors of the business.

Types of Structures

Sole Proprietorship

A sole proprietorship is a legal form of business that makes no legal distinction between the individual owner and the business itself. The owner of a sole proprietorship reports all business transactions of the proprietorship on Schedule C of form 1040. Income and expenses of the proprietorship retain their character when reported by the proprietor. For example, ordinary income of the proprietorship is treated as ordinary income when reported by the proprietor, and capital gains are treated as capital gain. Please note that Caring for People Services does not recommend this type of structure.

Advantages:

- Administrative setup and maintenance costs are low
- Relatively few regulatory requirements
- Owner is only taxed once on his or her personal income tax return

Disadvantages:

- Owner is personally liable for the actions of the company
- Can be difficult to raise capital for the business

Partnership

A partnership is an association of two or more persons to carry on a trade or business, with each contributing money, property, labor, or skill and with all expecting to share in profits and losses. For federal income tax purposes, a partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization through which any business, financial operation, or venture is carried on. The entity must not be otherwise classified as corporation, trust, or estate.

Partnerships are not subject to income tax. A partnership is required to file Form 1065, which reports results of the partnership's business activities. Most income and expense items are aggregated in computing the net profit of the partnership on Form 1065. Any income and expense items that are not aggregated in computing the partnership's net income are reported separately to the partners. The partnership net profits and separately reported items are allocated to each partner according to the partnership's profit sharing agreement and the partners receive separate K-1 schedules from the partnership. Schedule K-1 reports each partner's share of the partnership net profit and separately reported income and expenses items. Each partner reports these items on his or her own tax return.

Advantages:

- Administrative setup and maintenance costs are low
- Relatively few regulatory requirements
- Owner is only taxed once on his or her personal income tax return

Disadvantages:

- Owner is personally liable for the actions of the company
- Each partner is responsible for the business dealings of other partners. This is very important to understand. If Partner A enters into a very bad deal under the name of the partnership, then all other partners are responsible for making good under that contract. Consequently, selecting your partners is of crucial importance.

Other comments: The partnership agreement is the rule book of the partners. This can be drafted with the help of a qualified lawyer to help the partnership deal with such issues as:

- Initial investment of partners
- Distribution of profits and losses
- Each partner's responsibilities
- New partner entrance into partnership
- Old partner exit from partnership

Limited Liability Partnership

Limited liability partnership is similar to a general partnership, but with a separate classification of partners. A limited partnership is comprised of a general partner and multiple limited partners. Unless special rules apply, only the general partners are liable to creditors; each limited partner's risk of loss is restricted to his or her equity investment in the entity. Limited partnerships will likely be used for real estate development activities, so investors are protected against losses in excess of their investment.

C-corporation

A C-corporation is a legal form of doing business that creates a separate legal entity from the individual owners. This legal entity can act and does business on its own just as a person would (i.e. borrow money, enter into lawsuits and contracts, etc.)

Advantages:

- Shareholders are not personally liable
- Ownership is easily exchanged between individuals
- Company does not cease to exist with the death of owners
- Easy structure for which to raise capital

Disadvantages:

- Owners are taxed twice
- High administrative costs to set up and run
- More regulatory requirements than other structures

S-corporation

An S-corporation is a type of corporate legal form that is taxed like a sole proprietorship. Its formation is subject to certain legal criteria such as a maximum number of shareholders.

Advantages:

- Owners are only taxed one time
- Shareholders are not personally liable

Disadvantages:

- Higher administrative costs to set up and run than partnerships and sole proprietorships. More regulations than partnerships and sole proprietorships. Certain limitations on who can be an owner (U.S. citizens, etc.)

Limited Liability Company (LLC)

An LLC is a hybrid legal form of business that is taxed like a sole proprietorship with the same liability protection of the corporate structure.

Advantages:

- Owners are only taxed one time
- Shareholders are not personally liable

Disadvantages:

- Higher administrative costs to set up and run than partnerships and sole proprietorships
- More regulations than partnerships and sole proprietorships
- Limited life of entity (usually limited to 30 years)
- LLC laws are not uniform and therefore doing business in multiple states as an LLC can be complex

Other comments:

- No restrictions on the number of owners (S-corps limited to 75 owners)
- Can have non-U.S. citizens as members (S-corps cannot)
- More flexibility in distributing income (S-corps' percentage of ownership determines the amount of pass-through income)

LLC relative disadvantages over S-corporations:

- Need at least two people to form an LLC (S-corps only need one person)
- Limited life (S-corps are perpetual)
- LLC members need other members' approval to sell their interest (S-corps owners need no such approval)
- LLC may have to pay more self-employment taxes than S-corps due to IRS regulations forcing active LLC members to pay self-employment taxes on both salary and distributions from the company, as opposed to S-corps members who do not have to pay taxes on distributions.

Setting up the New Corporation

Reserve your corporate name with your state's Secretary of State; file Articles of Incorporation; file for Federal and State Tax Identification Numbers; file for trade name.

Procedures for filing Articles of Incorporation vary from state-to-state and the fees range from approximately $85 to $500. The online site TheCompanyCorporation.com lists fees for filing Articles of Incorporation by state. Most states now have online information available in addition to a toll-free number. Additionally, if time is of the essence in filing your incorporation papers, or if you prefer someone walk the papers through the process, there are businesses in your state capitol city that specialize in these matters. You will receive a federal tax number after filing the federal Employer Identification Number (EIN) form. You will need to purchase a 'corporate kit' that will include your corporate seal and original shares.

You will have both a corporate name and a trade name. Your corporate name is personal and unique to your particular business, while your trade name (also called fictitious name) is specific to the company. Your corporate name should not reflect any part of the wording of the trade name of the franchise. In most states, you may now search an online database to be certain you are not duplicating the fictitious name of another business, which may be trademarked. Contact your state corporation office by telephone if you cannot access an online site. You will fill out a sworn statement listing the name to be registered, mailing address of the business, name, and address of each owner or, if a corporation, the FEIN and state incorporation or registration number. Many areas require publication of an ad under the fictitious names column in the legal notices area, classified advertising section, of your official county newspaper. This is your official announcement that you, acting under your corporate name, intend to operate a business 'also known as' (aka) your trade name.

The types of federal taxes you will pay may include: income, federal income tax withholding, Social Security, Medicare, FUTA, excise, etc. The Internal Revenue Service can be contacted for information on tax matters at 800-829-1040 or online at www.irs.gov. The IRS issues a variety of publications and other aids to assist you in complying with tax laws, including forms.

The procedure for acquiring a state tax number is also specific to your state. The types of state taxes you will pay may include: tax on income, sales, capital gains, unemployment, etc. Contact your state revenue office either online or by calling its toll-free number. Request any publications available on state tax matters, as well as forms.

Most counties and local governments also levy taxes that you are responsible for paying. Contact your county and local governments for information on these matters and forms.

It is highly recommended that you engage the services of an attorney for the above procedures, preferably one experienced in corporate matters with a specialty in franchising. You should also engage the services of an accountant to assist you in setting up your corporation for operational and tax efficiency. Your choice of an accountant should be based in part on computer software compatibility. The costs incurred by engaging these two professionals will be more than offset by the advantages gained in using their expertise.

Assumed Name Certificate/DBA

Regardless of whether you will operate the franchised business as a sole proprietorship, a general partnership, or an LLC, you must file an assumed name certificate with the appropriate governmental office. The assumed name certificate is sometimes called a trade name certificate, a fictitious business name certificate, or a DBA registration. The appropriate governmental office is usually the county clerk, but you may be required to file at the state level and/or the city level. The purpose of this filing is so that the general public will be informed of the registered agent for a business and where official contact with the business can be made.

Generally, the required information includes the name of the business, the street address of the business, the name of the business owner(s), the type of business to be conducted and the expected period of operation. The expected period of operation should correspond to the initial term of the Franchise Agreement. Usually, each owner must sign the certificate and all signatures must be notarized. Fees generally range from $10 to $100. In some jurisdictions, you will need to place a fictitious name notice in a local newspaper for a certain amount of time.

Legal Status of Franchisee

It is important to understand and further define the relationship between Caring for People Services (franchisor) and you the (franchisee). While we share common goals, abide by common principles, and ultimately exist on some level for each other's benefit, we are not acting in the capacity or role of employer and employee, principal and agent, or general and limited partner.

We are a licensor, and you a licensee, of intellectual property. We have knowingly and voluntarily entered into an interdependent relationship, each depending on the other for success. We believe that the financial output of working together will far exceed that of going it alone. We must stay loyal to each other and respect each other, always searching for ways to strengthen the bond that exists. Complete transparency and open communication are the keys to our success.

Financing Arrangements

Financing is your responsibility. Caring for People Services does not finance or guarantee the obligations of the franchisee. In the future, we may elect to offer limited financing to the franchisee. Please contact Caring for People Services for more information.

The initial franchise fee is refundable only by the terms and conditions outlined in the Franchise Agreement.

Financing Alternatives

For most, the initial startup cost of a Caring for People Services franchise is a lot of money. Don't panic – here are all the stops on the way to getting your Caring for People Services franchise financed:

Your personal resources: Conduct an assessment of your own resources before you launch into your search for capital from banks or other lending institutions. First, prepare a personal financial statement (on a generic form from your bank or an office supply store, or by using your personal accounting software). You'll use it over and over again as you line up your financing. Also, make copies of your tax returns for the past two years – both a lender and a franchisor providing financing will want to see them. If your Uncle Doug once offered to back you in business, give him a call and take him to lunch. Be sure of what you can count on – you can't afford to go into the business with flimsy promises. Talk dollars and timing with good ol' Doug.

Your accountant: If you don't have an accountant, it's time to get one. Ask for references from friends and family, and find an experienced one who has handled small businesses (Tip: ask existing franchisees in your area for references). Arrange a preliminary interview, discuss your plans, and show the accountant your personal financial statement, the investment estimates from Item 7 of the FDD and any Item 19 earnings claim information in the FDD. Talk about how you can calculate a cash-flow picture of the business you're planning and how much financing you need. Ask the accountant to recommend a banker he or she has dealt with; usually accountants have great leads for their clients.

The franchisor: One thing can be said for franchising as a method of expanding business: It has developed a tried-and-true path for the individual investor. Financing is an important part of that path. In about 30 percent of all systems, the franchisor itself will provide financing directly or through a third-party lender. If this is available from your franchisor, it's laid out fully in Item 10 of the FDD. Even if the company does provide financing, it's likely to be for only a portion of your total needs.

The bank and specialty franchise lenders: It's fair to say every small business needs a solid banking relationship. Even if you don't find financing at your local bank, you'll need to build a day-to-day service relationship. The place to start is the bank where you do your personal banking. Talk to a banker about your plans and explore their programs.

Also contact independent lenders who specialize in franchise lending. Check out GE Capital Franchise Finance and Textron, two of the larger independent sources.

The SBA Franchise Registry: The real secret to bank financing for a franchise investment is the SBA, which has very aggressively rolled out its small-business lending guarantee program. Banks that participate in this program can significantly reduce their lending risks, because the SBA guarantees a large portion of the loan against your failure or inability to repay the loan. Contact the SBA and inquire at banks in your local area; this is a powerful program for new business buyers.

The SBA has enhanced the power of its program by working with franchisors to streamline the application and qualification process, creating the SBA Franchise Registry. Go to www.franchiseregistry.com for a list of franchisors that have registered their systems with this unique SBA program. If your franchisor is one of the hundreds that are listed, you're in luck – it'll save you lots of time and a ton of paperwork.